

# **Report of the auditor-general to the Free State Legislature and the council on the Kopanong Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Kopanong Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### **Receivables from exchange transactions**

6. The municipality did not write off receivables from exchange transactions accurately during the 2013-14 financial year in terms of SA Standards of GRAP, GRAP 104 *Financial instruments*. The determination of the amounts to be written off as irrecoverable was done incorrectly and did not agree to the amounts approved for write-off by the council. Consequently, receivables from exchange transactions were overstated by R9 141 734 (2014: R9 141 734).

### **Trade and other payables from exchange transactions**

7. The municipality did not write off receivables from exchange transactions accurately during the 2013-14 financial year in terms of SA Standards of GRAP, GRAP 104 *Financial instruments*. The determination of the amounts to be written off as irrecoverable was done incorrectly and did not agree to the amounts approved for write-off by the council, resulting in numerous accounts with incorrect credit balances. Consequently, debtors' payments in advance, included in trade and other payables from exchange transactions for the current and prior financial years, were overstated by R5 287 725 (2014: R5 287 725).

### **Aggregation of immaterial uncorrected misstatements**

8. The financial statements were materially misstated due to the cumulative effect of individually immaterial uncorrected misstatements in the following items included in the statement of financial position, and the statement of financial performance and the notes to the financial statements:
  - Refuse removal reflected as R7 179 096 and trade receivables from exchange transactions for refuse reflected as R2 612 177 were understated by R511 753. Sewerage and sanitation charges reflected as R9 754 375 and trade receivables from exchange transactions for sewerage reflected as R3 620 300 were understated by R549 669.

I was unable to obtain sufficient appropriate audit evidence regarding the following item included in the statement of financial performance and the notes to the financial statements, which had a cumulative effect on the financial statements:

- Rental income of R785 623 as included in the disclosed total of Other income of R1 414 864.

I was unable to confirm this item by alternative means. Consequently, I was unable to determine whether any adjustment to this item was necessary.

## **Qualified opinion**

9. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Kopanong Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.



## **Emphasis of matters**

10. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

11. As disclosed in note 17 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an errors discovered during 2014-15 in the financial statements of the Kopanong Local Municipality at, and for the year ended, 30 June 2014.

### **Irregular expenditure**

12. As disclosed in note 36 to the financial statements, the municipality incurred irregular expenditure of R12 878 240 (2013-14: R37 782 366) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements. In addition, the full extent of irregular expenditure is still being determined.

### **Material losses**

13. As disclosed in note 39.1 to the financial statements, material water losses of 61% (2013-14: 64%) were incurred as a result of unmetered areas and poorly maintained infrastructure.

### **Material impairments**

14. As disclosed in note 4.1(a) to the financial statements, a provision for impairment of trade receivables from exchange transactions amounting to R72 547 026 (2013-14: R45 222 874) was made with regard to consumer receivables amounting to R99 510 773 (2013-14: R61 671 794).
15. As disclosed in note 4.2(a) to the financial statements, a provision for impairment of receivables from non-exchange transactions amounting to R14 228 862 (2013-14: R8 738 639) was made with regard to property rates amounting to R17 668 618 (2013-14: R11 789 058).

### **Going concern**

16. Note 32 to the financial statements indicate that the Kopanong Local Municipality incurred a net loss of R80 514 644 (2013-14: R49 509 995) during the year ended 30 June 2015 and, as of that date, the municipality's current liabilities exceeded its current assets by R147 237 430. These conditions, along with other matters as set forth in the note 32, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

## **Additional matter**

17. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Unaudited supplementary information

18. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon

## Unaudited disclosure notes

19. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## Report on other legal and regulatory requirements

20. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas (KPA) presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected KPAs presented in the annual performance report of the municipality for the year ended 30 June 2015:
- KPA 1: Service delivery and infrastructure on pages x to x
  - KPA 2: Institutional development and transformation on pages x to x
22. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
23. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the selected key performance areas are as follows:



## **KPA 1: service delivery and infrastructure**

### Usefulness of reported performance information

26. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 36% of the targets were not specific.

### Reliability of reported performance information

27. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of monitoring of the completeness of source documentation in support of actual achievements.

## **KPA 2: institutional development and transformation**

### Usefulness of reported performance information

28. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 60% of the targets were not specific.
29. I did not identify material findings on the reliability of the reported performance information for the following key performance area:
- Institutional development and transformation

## **Additional matters**

30. I draw attention to the following matters:

### Achievement of planned targets

31. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance areas reported in paragraphs 26 to 29 of this report.

### Adjustment of material misstatements

32. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for key performance area: service delivery and infrastructure and key performance area: institutional development and transformation. As management subsequently corrected only some of the misstatements, I identified material findings on the usefulness and reliability of the reported performance information.

## Unaudited supplementary information

33. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

## **Compliance with legislation**

34. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Financial statements and annual report**

35. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, current liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion

## **Expenditure management**

36. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
37. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Revenue management**

38. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
39. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.
40. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

## **Asset management**

41. Capital assets were permanently disposed without the approval of the council, as required by section 14(2)(a) of the MFMA.

## **Procurement and contract management**

42. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.



## **Audit committee**

43. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
44. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
45. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).

## **Consequence management**

46. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

## **Human resource management and compensation**

47. The municipality did not develop and adopt appropriate systems and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the Municipal Systems Act, 2000 (Act No. 32 of 2000).

## **Internal control**

48. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

49. There has been a slow response from leadership in implementing and monitoring the audit action plan to address qualification areas and internal control deficiencies identified during the previous audits. Leadership could not adequately exercise their oversight function over financial, performance and compliance matters effectively due to the lack of credible and accurate information submitted by management.

## **Financial and performance management**

50. The issues identified in the previous year were not given priority attention which resulted in actions being taken late in the financial year. Action plans and other engagements were not effective in driving improvements in the audit outcome.

51. Officials do not fully understand the applicable performance reporting requirements which in turn contributed to the deterioration in performance measures within the organisation.

## **Governance**

52. The effectiveness of the internal audit unit and the audit committee was limited by the slow response by the leadership and management in implementing the recommendations made by these two governance structures.

## **Other reports**

## **Investigations**

53. As reported in previous audit reports, the municipality was still awaiting a report from the Special Investigations Unit (SIU) relating to several issues of non-compliance with the municipal policies. At the date of this report, feedback from the SIU was still outstanding.

*Auditor - General*

Bloemfontein

11 December 2015



AUDITOR - GENERAL  
SOUTH AFRICA

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